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OPEN MEETING AGENDA ITEM



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UniSourceEnergy
SERVICES

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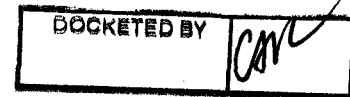
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AZ CORP NOV 24 2004
DOCUMENT CONTROL

The Arizona Corporation Commission
Marc Spitzer, Chairman
Mike Gleason, Commissioner
Jeff Hatch-Miller, Commissioner
Kristin Mayes, Commissioner
William Mundell, Commissioner
1200 W. Washington
Phoenix, Arizona 85003

Arizona Corporation Commission
DOCKETED

NOV 24 2004



RE: Docket No. E-04230A-03-0933 UniSource Energy Corporation
("UniSource"), and Guardian Fiberglass, Inc. ("Guardian")

Dear Chairman and Commissioners:

The assertion by Guardian Fiberglass, Inc. ("Guardian") that UniSource Energy Services ("UES") has not honored representations made to Guardian is completely unfounded. UES (and prior to the acquisition, Citizens) communicated openly and honestly with Guardian representatives throughout their organization regarding the proposed contract, the acquisition and the then pending Purchased Power Fuel Adjustor Clause (PPFAC). Neither UES nor Citizens ever represented to Guardian that it would be bound by the terms of an unsigned contract that had not been approved by the Arizona Corporation Commission ("ACC"). As part of the acquisition process, the ACC approved a PPFAC adjustment, which was applied to all customers in every class. Guardian has repeatedly requested relief from the adjustment by claiming that a pre-existing contract existed. Because the adjustment was solely related to the cost of power UES procures from its wholesale supplier, UES has offered to allow Guardian the flexibility to locate and purchase less expensive power; however, Guardian has been unable to do so.

Further, Guardian has attempted to manipulate the proposed contract to its benefit without regard to the actual events surrounding the contract negotiation. When the contract price was above the tariff rate, Guardian did not want the proposed contract; when the contract rate was below the upcoming tariff plus the adjustment, Guardian claimed the proposed contract was in effect.

We are informed that Citizens conducted contract negotiations between March and December of 1998. In April 1999, prior to a draft contract, Guardian located their plant in Kingman, Arizona and began taking power. In October 1999, Citizens presented a contract to Guardian. The contract clearly stated, in Section 7, Term, and in Section 8, Approval by Commission, that the term would begin upon execution, and that "The rights and obligations of each of the parties are of no force and effect until this (Commission) approval has been obtained." Guardian did not execute the contract; therefore the contract was never presented to the ACC by Citizens for approval.

At the time the contract was offered, the rate Guardian would have paid was higher than the tariff rate, but the proposed contract would have provided stability and certainty in rates – that would not change, even if tariffed rates did increase. Guardian continued to pay the lower tariff rate for eleven months after the contract was offered (October 1999 – September 2000). When it became apparent that the cost of energy would increase the PPFAC, Guardian contacted Citizens stating that they believed the proposed contract to be in effect, and began making payments in accordance with perceived contract terms. In letters dated October 12, 2000 and January 3, 2001, Citizens informed Guardian that the contract was not in effect, and that the overpayments could either be refunded or applied to future billing.

Throughout the UES acquisition of Citizens, UES personnel have maintained open communications with Guardian personnel, explaining the rate surcharge, why it occurred, and the specific impact to Guardian. Senior management at UNS met with Guardian management to discuss the future relationship and past issues. A representative of Guardian told UES that the issues regarding the unexecuted contract were “past history” and that he was anxious to move forward in a positive relationship. However, when UES began passing through the adjustment for Guardian, the proposed contract issue was resurrected.

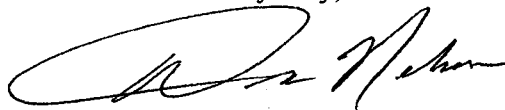
UES is a distribution company that procures power on behalf of its customers. Due to market conditions, the cost of power had increased significantly over time. When UES purchased Citizens, it did not ask for recovery from its customers for the accumulated negative bank balance of \$130 million. However, UES could not operate going forward by continuing to accumulate a negative bank balance. The adjustment did not provide an increased rate of return for UES. The adjustment covered the difference between what Citizens was collecting versus the cost of the power contract. It would put undue pressure on other customers to allow Guardian to be subsidized by other customers and classes.

UES fully appreciates the impact the adjustment has on Guardian and other customers. Although it would not be prudent for UES to operate at a loss (or to allow other customers to subsidize Guardian) and because it is the cost of power that has driven the surcharge, UES has offered to create a special contract with Guardian to allow them early access to the market if 1) they could obtain power at a lower cost 2) UNS would be held harmless by Pinnacle West (with whom UES has a full requirements contract) and 3) the ACC would approve such access. To the best of our knowledge, Guardian has not been able to locate less expensive power.

UES takes very seriously its obligation to serve its customers. UES is, and shall continue to work with customers to attempt to meet their needs. It is our responsibility to charge customers rates that are fair and reasonable within the bounds of prudence.

Please feel free to call me if you have any questions.

Yours very truly,

A handwritten signature in dark ink, appearing to read "Dennis R. Nelson", written over a horizontal line.

Dennis R. Nelson
Senior Vice President and
Chief Operating Officer

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